BEFORE THE

FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: :
CONSENT MARKETS, TARIFFS AND RATES - ELECTRIC :
CONSENT MARKETS, TARIFFS AND RATES - GAS :
CONSENT ENERGY PROJECTS - HYDRO :
CONSENT ENERGY PROJECTS - CERTIFICATES :
DISCUSSION ITEMS :
STRUCK ITEMS :
- -x

905TH COMMISSION MEETING

OPEN MEETING

Hearing Room 2C
Federal Energy Regulatory
Commission
888 First Street, N.E.
Washington, D.C.

Thursday, May 19, 2006
10:10 a.m.

APPEARANCES:

COMMISSIONERS PRESENT:

CHAIRMAN JOSEPH T. KELLIHER

COMMISSIONER NORA MEAD BROWNELL

COMMISSIONER SUEDEEN G. KELLY

SECRETARY MAGALIE R. SALAS

ALSO PRESENT:

DAVID L. HOFFMAN, Reporter

P R O C E E D I N G S

(10:10 a.m.)

CHAIRMAN KELLIHER: Good morning. This open meeting of the Federal Energy Regulatory Commission will come to order to consider the matters that have been duly posted in accordance with the Government in the Sunshine Act for this time and place.

Please join us in the Pledge of Allegiance.

(Pledge of Allegiance recited.)

CHAIRMAN KELLIHER: I'm going to start the meeting with the usual announcements about some recent activities and upcoming activities.

First of all, the Market Monitors meeting: I would like to begin the meeting with a reminder that this afternoon, here in the Commission Meeting Room, the RTO and ISO Market Monitors will make presentations to my colleagues and me on the Monitors' role and priorities in the relevant markets.

All interested persons are invited to attend. A free webcast of this event will be available through www.ferc.gov.

I'd like to now recognize the Market Monitors who are with us this morning: John Buechler from the New York ISO; Hung po-Chao, from ISO New England, David Patton, with the Midwest ISO, and Keith Casey, with the California ISO.

I saw Joe Bowring in the building yesterday, but I guess he's not here today.

Secondly, I'd like to make some comments about the recent joint meeting we had with the Nuclear Regulatory Commission. On April 24th, the Commission held a joint meeting with the Nuclear Regulatory Commission to discuss our common interests in assuring the reliability of the bulk power system.

At this meeting, we shared information that will assist the coordination between our Agencies, both in maintaining the day-to-day operations of the nation's bulk power system, as well as to help ensure that there are no unforeseen regulatory hurdles to the planning and installation of transmission system improvements necessary to serve new nuclear power plants.

Also at the meeting, the Commission received insight from the Nuclear Regulatory Commission's experience, which will assist the Commission in fulfilling our new responsibility under the Energy Policy Act of 2005, to assure the reliability of the bulk power system.

My colleagues and I look forward to additional dialogue and cooperation to assure the safe and reliable operation of both the nuclear power plants and the bulk power system of the United States.

I thought it was an interesting meeting. It was kind of interesting to see how a different agency approaches issues, kind of procedurally how they approach issues.

It was also unusual to see a five-member Commission.

(Laughter.)

CHAIRMAN KELLIHER: In person.

COMMISSIONER BROWNELL: Soon, Joe, soon.

CHAIRMAN KELLIHER: I also want to compliment Susan Court for her leadership in organizing the meeting, as well as Joe McClelland, for a lot of the hard work and the presentations at the meeting.

The next item: The Commission recently, on May 11th, took an important step toward implementing mandatory reliability standards for the nation's bulk power system, as required by the Energy Policy Act of 2005, by issuing a preliminary assessment of the proposed reliability standards submitted for Commission approval by the North American Electric Reliability Council.

The proposed standards in NERC's petition, are the same as existing voluntary reliability standards currently overseen by NERC. Although these standards were not filed by NERC until April 4, this assessment is the product of a month-long review, a constructive review by Commission Staff, that we initiated late last year in anticipation that the existing standards would be what is submitted.

We didn't see any reason to wait for the actual submission of the standards to begin this review.

Now, we began the review with the assumption, as I said, that those standards would be submitted and the Staff's assessment concluded; that although there are flaws in many of the proposed standards, and there are certain categorical flaws, that the proposed standards do represent a solid foundation for enforceable reliability standards in the future.

Now, we have asked NERC -- we've directed NERC to respond to the preliminary assessment within 45 days, I believe. We intend to hold a technical conference on our preliminary assessment.

We've also asked for public comments on the preliminary assessment. I just want to emphasize that this is really the beginning of a process.

This represents hard work by the Commission Staff that took place over a six-month period. I was very impressed with the high quality of the preliminary assessment. It really shows the expertise that the Commission has developed in the area of reliability standards.

But it is the beginning of a process. At the end of the process, we will be establishing reliability standards, but this is our initial constructive review of the proposed standards, and we look forward to NERC's response and the public comments.

The next area is a change in the Commission's constituent letter policy. The Commission received a great deal of mail from Congress. Frequently, the mail is directed from a constituent, who, in turn, has written to a Senator or House Member.

As Chairman, I tend to see most of the Congressional mail, and my colleagues do, as well, but we are changing our policy with respect to these constituent letters.

The Commission's regulations require that communications from elected officials, relating to a contested, on-the-record proceeding, be included in the Commission's public files and be made available for public inspection and comment.

Congressional letters pertaining to contested proceedings, have been routinely included in the Commission's public files, however, this requirement also applies to letters from constituents, transmitted to the Commission by elected officials, rather than letters that constituents have sent directly to the Commission.

Previously, such constituent letters were placed in the non-public file to protect personal identifying information concerning the constituent.

I just want to make sure that Congress is advised, and the Commission has separately advised Congress that constituent letters that relate to contested proceedings before the Commission, will be included in the public file, but they will be redacted to remove personal identifying information such as the constituent's name, home address, phone number, e-mail address and Social Security Number.

It will then be placed in the Commission's public files, along with the Congressional letter of transmittal.

Next, I would like to recognize that John Moot who recently testified, our General Counsel and Director of the Office of Energy Projects, recently testified before the Senate Energy and Natural Resources Committee on implementation of the Energy Policy Act of 2005.

Mark testified on the implementation -- on the Commission's implementation of the hydro provisions, the alternative licensing provisions that were in EPAct, and he joined representatives from some of the federal resource agencies and other stakeholders.

John testified just this past Monday before the Committee on Implementation of Reliability Standards. That testimony is available on our website, as well as the Committee's website.

Next, Tom Saulk Dam update: As I previously mentioned, teams of FERC engineers have been investigating the dam breach at the Tom Saulk hydroelectric project near Lesterville, Missouri, since the dam breach took place.

In fact, Commission Staff were onsite within a matter of hours. On April 28th, the Commission Staff released a report on the dam breach, which includes information on the potential causes of the breach.

The purpose of the report was to present the results of the Commission Staff's investigation to the independent panel of experts that we've retained to investigate the incident.

This panel should be releasing its own findings sometime in the near future. This report, the Commission's report, the Staff report, is available in its entirety on our website, www.ferc.gov, on a web page dedicated exclusively to the Tom Saulk Dam breach.

Next, I'd like to talk about an upcoming event, at technical conference on the PJM RPM proposal. I'd like to mention that on June 7th and 8th, the Commission will be hosting a Staff Technical Conference at the Commission on the PJM Interconnection's Reliability Pricing Model Proposal.

A Supplemental Notice with the Agenda for the meeting, will be issued shortly. This technical conference stems from the April 20 initial Order on the Reliability Pricing Model issued by the Commission.

The purpose of the conference will be to address specific issues relating to the mechanisms to be used by PJM to enable customers to satisfy reliability requirements.

This conference is intended to be an informal working session, focused solely on determining the appropriate parameters for the variable resource requirement and the long-term fixed resource adequacy requirement accepted by the Commission in our initial Order on the reliability pricing model.

Certain parties recently filed a motion asking us to establish Settlement Judge proceedings and to suspend the paper hearing and technical conference proceedings that we established in the April 20th Order.

Yesterday, the Commission issued an order granting the motion for a Settlement Judge, but denying the request to suspend our proceedings. We encourage the parties to settle this matter, but we also need to be sure that we have a fully developed record, in the event that the parties are not able to reach a settlement and further Commission action is required.

Another upcoming meeting I would like to announce, is the announcement of the PUCHA Accounting Technical Conference. On July 11th, the Commission Staff will be holding a technical conference, beginning at 9:00 in the Commission meeting room, to discuss components of the Notice of Proposed Rulemaking on Financial Accounting Reporting and Records Retention Requirements, and the Public Utility Holding Company Act of 2005, that the Commission issued at our previous meeting.

This conference was originally noticed for June 21st, so there's a date change. The purpose of this conference is to identify the issues associated with the proposed Uniform System of Accounts for Centralized Service Companies, the proposed Records Retention Requirements for holding companies and service companies, and the revised Form No. 60.

Discussions at this Technical Conference will assist Commission Staff in preparing a final rule on this proceeding.

Before we get to other business, I'd just like to note that since the April 20th open meeting, the Commission has issued 92 Notational Orders, more than four a day, every day, every business day since then.

So, the green blizzard continues at the Commission. I appreciate the Attorney Advisors very much, as well as my colleagues for doing so much work in between the meetings.

It allows us to focus on the major Orders that we're dealing with today, to, I think, a great extent. With that, I'd like to ask my colleagues if they have comments on some of these new business and upcoming business matters or other issues.

COMMISSIONER KELLY: Thank you, Joe. Thank you. I don't have any comments, but I have an announcement that's a little bit more rousing than the PUCA accounting technical conference -- no offense to PUCA or anything. But today is Nora's birthday.

(Applause.)

(Happy birthday sung.)

COMMISSIONER BROWNELL: I won't talk about aging with style and grace, but I will say that emerald is my birthstone.

(Laughter.)

COMMISSIONER BROWNELL: And champagne is my acceptable drink.

Thank you everyone. I can't think of a better group of family to spend my birthday with.

(Laughter.)

CHAIRMAN KELLIHER: I hope people watching the website were singing as well.

(Laughter.)

CHAIRMAN KELLIHER: Madam Secretary, let's turn to the consent agenda.

SECRETARY SALAS: Good morning, Mr. Chairman, and good morning, Commissioners, and very happy birthday, Commissioner Brownell.

Since the issuance of the Sunshine Notice on May

11th, H-3 was struck from the agenda. Your consent agenda for this morning is as follows: electric items E-4, 5, 6, 7, 9, 10, 12, 14, 15, 18, 20, 22, 23 and 25. Hydro items H-1, 2, 4, 5 and 6. Certificates C-3 and C-5. As to E-14, one of the consent items, Commissioner Kelly is dissenting in part with a separate statement.

Commissioner Kelly votes first this morning.

COMMISSIONER KELLY: Aye, with the exception of my partial dissent in E-15.

COMMISSIONER BROWNELL: Aye.

CHAIRMAN KELLIHER: Aye.

SECRETARY SALAS: One of the assistants is telling me that it should be E-15, not 14.

CHAIRMAN KELLIHER: E-15 is where Commissioner Kelly had a partial dissent or a full dissent?

COMMISSIONER KELLY: Partial.

CHAIRMAN KELLIHER: A partial dissent on E-15.

SECRETARY SALAS: Well, for the record, did you get that?

All right. The first item for discussion this morning is A-3, the summer energy market assessment. It is a presentation by Steve Harvey, Dean White, Keith Collins and Chris Peterson.

MR. HARVEY: Mr. Chairman, Commissioners, today I'm pleased to present the Office of Enforcement's summer energy market assessment for 2006. With me are Dean White, who runs the electric group in our market analysis branch, Keith Collins, who works for Dean, and Chris Peterson, who works in the gas group. Much of what I will present today comes out of observations in our daily energy oversight meetings. Keith and Chris currently have the responsibility of running those meetings and, as a result, probably know more than any of us about the current day-to-day workings of electric and gas markets in the United States. At the end, if you have any questions, you will understand why I will probably defer those questions to them.

The summer assessment is designed to share our opinions about those markets that the staff of the Division of Energy Market Oversight will be watching most carefully for indications of market problems throughout the summer. Having said that, the issues I presented are by no means the only ones we're watching. Also, nothing I say should be confused as a prediction; we don't make predictions. Still, the assessment can help identify those markets where signals may be of most interest.

(Slide.)

This year's summer assessment will focus on three general areas that we think will be the most significant drivers of electricity markets as we enter the summer cooling season. Those areas include a review of the four load pockets most likely to face issues of scarcity, including high prices, a few RTOs where rule and operational changes may have notable operational effects, and a quick review of some of the underlying fuel and supply conditions that are likely to drive electricity prices broadly.

(Slide.)

The four major areas with likely scarcity issues we've chosen to focus on include southern California, southwest Connecticut, Ontario and Long Island. While Ontario is, of course, in Canada, the issues raised by the Ontario market could have repercussions in adjacent U.S. markets.

Southern California faces another summer of tight supply in an area of fast growing demand. The particulars are viewed slightly differently in assessments by the California Energy Commission, the California ISO and NERC. The region remains heavily dependent on imports from northern California, the Pacific Northwest and the Southwest, particularly to meet peak demand. We expect net generation added in southern California since last year will barely cover load growth, though transmission upgrades may have marginally improved import capabilities.

(Slide.)

Overall, with tight reserve margins, the area is vulnerable both to high peak demand from periods of heat and to unplanned outages of generation or transmission capacity needed to maintain imports. Instances of short duration are obviously of less concern than more extended tightness. The California ISO expects typical peak demand in southern California during the summer to be about 27,300 megawatts, with peaks under high load scenarios of more than 29,500 megawatts. Local generation adjusting for likely outages totals a little less than 20,000 megawatts and at the peak the ISO expects 10,100 megawatts to be imported or fully one-third of southern California's supply.

Our assessment, consistent with the ISO and NERC, is that if loads or unexpected outages are high, the ISO will call on interruptible demand and demand response to maintain adequate operating reserve margins. In the high load scenario, due for example to sustained heat and the sudden loss of local generation or transmission, the ISO might need to shed load through rolling blackouts in southern California this summer.

This extreme scenario is fairly unlikely despite similar conditions last summer. Relatively mild temperatures made sure that there were no real wholesale electric problems in southern California. Nevertheless, such a scenario is possible. Electric systems experienced combined heat and equipment failure in the past and the likelihood of such a combination this summer is as great in southern California as anywhere.

(Slide.)

The price effects of this tightness on customers are not likely to be as pronounced as one might expect. The ISO's balancing market will probably be quite volatile as it attempts to balance marginal supply with overall demand. However, last fall as one of the efforts to manage through these conditions the California Public Utilities Commission, or CPUC, established resource adequacy requirements for all load-serving entities within the CPC's jurisdiction. These load-serving entities were required to procure resources adequate to meet their peak demands and planning reserves, identifying resources one year in advance to meet 90 percent of summer peak demand and demonstrating for June 2006 and every month thereafter the procurement of resources equal to at least 115 percent of forecaster monthly peak load. This level of contracting for resource adequacy purposes may reduce southern California imbalance market price volatility.

(Slide.)

Another region that has concerned us for several years now is southwest Connecticut which, once again, faces extreme tightness in its supply/demand balance. In southwest Connecticut, combined local generation and import transmission capacity are not sufficient to meet both expected demand and reliability requirements. In effect, transmission capacity for imports now operates at its limit.

In addition, transmission capacity within southwest Connecticut is inadequate to support local generation. No significant generation or transmission capacity has been added since 2004, and current plans indicate that transmission improvements that would allow additional imports will not be completed until late-2009, though improvements to transmission capacity within the region should be completed by the end of the year.

(Slide.)

As in the case of southern California, the most important threats to the electricity markets in southwest Connecticut come from extended periods of summer heat and from unplanned outages of local generation or of import-related transmission. In addition, widespread periods of heat in the northeastern United States could result in limited supplies available for import into southwest Connecticut. Overall, the fragility of the infrastructure into and within the region makes high prices and other problems possible and maybe even likely.

(Slide.)

Resulting price effects in southwest Connecticut are difficult to assess. Continued high zonal prices due to congestion are likely as relatively expensive generation alternatives will have to be called on to meet load and reliability requirements. In addition, the scarcity pricing approach adopted by ISO New England in 2003 could increase prices if used, although the ISO has implemented it only once before, in October 2005. At the same time, demand is unlikely to be much affected by wholesale price signals because the current retail standard offer rate used by 97 percent of retail customers in Connecticut will not change until the end of the year. More likely, in cases of supply/demand imbalances, the ISO will use a nonmarket set of emergency procedures to manage load such as dispatching and paying generators on an outside-the-market basis. In addition, southwest Connecticut has about 300 megawatts of demand response resources available.

(Slide.)

The Canadian province of Ontario has a load pocket that relies on adjacent U.S. electric markets in New York and Michigan, as well as the province of Quebec to meet its demand. Although Ontario has seen modest improvements in generation and transmission, our view, based on NERC's recent assessment is that Ontario had lost some of its already tight capacity margin since last summer when it had to use emergency control actions aggressively to balance its peak demands.

(Slide.)

As a load pocket, Ontario remains vulnerable to extended periods of heat as well as to unexpected outages. Given its dependence on imports, it is also vulnerable to import restrictions if there is heat across the northeastern United States.

(Slide.)

One of our concerns with the supply/demand balance problems in Ontario is the effects it may have on U.S. markets. Demands for emergency energy could make balancing supply and demand in New York and in the Midwest more difficult and certainly more expensive. Ripple effects could be felt in PJM and New England as well.

In addition, last summer Ontario disrupted imports frequently, causing a variety of commercial problems. Fortunately, Ontario's independent electric system operator has implemented a day-ahead commitment process which may take care of this issue this summer.

(Slide.)

We've been concerned about New York city and Long Island for several years, given the perennial tightness in electric supply and demand in those markets. In New York city, however, recent generation investments appear to have relieved some reliability concerns. Given the price of gas-fired generation at the margin, market prices are expected to remain relatively high in the city, though reserves appear adequate. On Long Island, however, supply/demand balances remain tight.

(Slide.)

As a consequence, Long Island remains exposed to the same kinds of risks associated with the other load pockets we've considered, mainly heat and unexpected generation and transmission outages.

(Slide.)

The result is likely to be continued volatility in day-ahead and real-time electric prices on Long Island, with very high prices when supply is tight. The New York ISOs scarcity pricing program, implemented in 2003, is likely to continue to generate high prices at those times when tight markets means reserves are being used for energy.

(Slide.)

I'll shift now to consider how observed changes in market rules or operational procedures in certain RTOs are likely to change the patterns visible in prices this summer.

(Slide.)

The first market is the New York ISO, which is making some changes in its price modeling to improve its ability to reflect physical realities. On May 1st, the New York ISO modified its real-time software to include a set of New York city constraints previously modeled only in its day-ahead software. Convergence between day-ahead and real-time prices should improve as a result, because both will now be monitoring a similar set of constraints. The changes do not affect day-ahead results or transmission congestion contracts settled off of day-ahead congestion.

Also, the ISO is planning to implement software by the end of May that better accounts for the real-time operational characteristics of gas turbine operations. The current real-time pricing mechanism overstates the maximum output of gas turbines during the summer months. When temperatures are hot, gas turbine efficiency decreases, lowering output levels. The current real-time pricing model assumes that the units can still reach maximum output levels. On several days in the past, differences between the desired output and the actual output of these plants were significant, resulting in prices that did not reflect actual system conditions. The new software is designed to account for the actual conditions of the gas turbines, thus real-time prices should more accurately reflect system operations, particularly during periods of scarcity in New York city and Long Island, where most gas turbines are located.

Again, day-ahead pricing is not affected by these changes. We're not certain exactly how these model changes will affect the level of volatility of prices, though they are intended to make real-time prices reflect underlying operations better.

(Slide.)

PJM has made changes with regard to its dispatch that have affected real-time prices and will affect them into the summer. In order to meet daily peaks and valleys in demand, PJM must ramp up and down a set of less flexible steam units. Last year, they tended to run a certain number of steam units at minimum levels between peaks to respond as needed to meet unexpected loads. This procedure tended to force down real-time prices because the remaining load was served by units lower in the bid stack, although it generated higher uplift costs, known in PJM as operating reserve charges.

In the second half of 2005, PJM began to reduce the number of steam units left running between peaks to reduce these operating reserve charges. PJM began using quick start gas-fired combustion turbine capacity to meet unexpected loads rather than steam units running at minimum load. In part because of this change, operating reserve costs have come down; at the same time, real-time prices are higher in some hours, even climbing to combustion turbine levels on occasion. Staff has observed the effects of this change on short-interval real-time pricing and expects that it might affect short-term prices during the summer.

Overall, however, if the changed approach to dispatch works as it's intended, it should lower overall costs. The cost of bringing on quick-start units occasionally should be less than that of running more steam units all the time.

(Slide.)

Effective this year on January 14, the bid cap in California was raised from $250 to $400 per megawatt-hour. The graph shows Staff's tracking of bids above $250 since the change on January 14. Through April, prices during 86 five-minute intervals have risen materially above the old cap level of $250 per megawatt-hour, indicating that generators have been making use of the additional bidding flexibility. These spikes are almost entirely concentrated in hours where the California ISO requires use of a limited supply of fast ramping unit, usually morning and evening hours. These intervals are represented by the red columns. Note that the daily average prices have not been affected much. Prices about $250 per megawatt-hour have occurred in only about 3 percent of the five minute intervals in the first quarter.

(Slide.)

Finally, I'd like to consider underlying summer fuel and supply conditions, with a focus on hydroelectric power in the Pacific Northwest, coal, oil and natural gas.

(Slide.)

Last year, we expressed our concerns in the summer outlook about relatively poor western hydroelectric generating conditions. This year the situation is quite different. Snow pack levels are quite robust. For example, as of May 12th, average snow pack in the mountains feeding the Columbia River Basin was about 6 percent above historical average, while snow pack in California was about 66 percent above average. On May 5th, the Northwest River Forecast Center forecast the April through September runoff of the Columbia River at The Dalles dam at 2 percent above average. By contrast, last year's outlook in early May was only two-thirds of average.

Overall, hydroelectric generation in the Pacific Northwest has been strongly above last year's levels and above the past five year range. Consequently, spring electric prices in the Northwest have been relatively low and conditions for the summer are much improved over what we expected last summer. Last summer our early concerns did not play out as expected because of unexpected spring rains and relatively mild California temperatures. This year, hydro supplies in the western United States start the summer in better shape.

(Slide.)

Coal stockpiles for electric generation have also faced some stress over the past few years. Currently coal stockpiles, as reported by the Energy Information Administration and most recently estimated by a Stifel Nicholas analyst, remain below their five year average for the first quarter of the year but are well above last year's levels and may have reached, at the end of April, levels above those in 2004.

Railroad disruptions and strong coal demand for generation in the face of high natural gas prices have driven lower stockpile levels for the past few years. While worth watching, Staff's view is that coal stockpiles are likely to continue building.

(Slide.)

MR. HARVEY: The recent relative weakness of natural gas prices vis a vis oil, seems to be having a variety of effects on fuel markets.

We've begun to see the first indications of fuel switching away from oil and towards natural gas. This graph is of gas deliveries into Florida through interstate pipelines.

Over the past few weeks, gas delivered into Florida, has averaged about 50 percent, fully one billion cubic feet a day above last year's levels.

While Florida has seen some growth, a large part of this increase appears to be related to fuel switching away from residual fuel oil. Staff has confirmed this switching in Florida, and has observed a similar, though lower volume trend in New York State.

If it continues, oil may play a smaller direct role in electricity prices this summer than we've seen in the recent past.

(Slide.)

MR. HARVEY: Finally, natural gas prices continue to face mixed pressures. Short-term prices remain at last year's levels despite far higher levels of current storage inventories, and, actually, in yesterday's trading, was down about 25 cents from the same day last year, so it's actually begun to sink below that.

Futures prices, though they have weakened recently, signal upward pressures throughout the summer and especially into the winter. Likely to be pushing prices up, are concerns about the upcoming hurricane season in the Gulf, continuing outages from Hurricanes Katrina and Rita, and ongoing international uncertainty about the price of oil.

Likely to be pushing prices down, are current storage inventories, recent strength in injections, and apparent production increases, particularly relevant to the western United States.

Day to day through the summer, we expect regional natural gas price volatility and associated electric price volatility, based on changing weather forecasts, as much as anything. Reports of tropical storms heading for the Gulf of Mexico, or of high temperatures localized around population centers, are likely to generate concerns about short-term supply and demand among traders, and force prices up, at least temporarily.

As a consequence, we review forecasts at a regional level daily in our oversight meetings, to help assess price movements. Altogether, conditions faced by U.S. electricity markets at the onset of the summer, appear to be stronger than last year, reflecting better underlying fuel conditions.

Changes in RTO rules and operational procedures appear to be increasingly reflecting operational realities and efficient dispatch, though these changes could increase price volatility in real-time markets.

Finally, Staff continues to be concerned about key load pockets where investment in needed infrastructure has not kept up with needs. We will continue to watch these areas throughout the summer, on every trading day, and report back to you, as needed, about these and other relevant market issues.

We'd be delighted to answer any of your questions.

COMMISSIONER BROWNELL: You talked about coal stockpiles, overall, going up. That seems to be more of a regional issue, if our anecdotal evidence is true.

Are you looking at that regionally? Can you break it down for us? It doesn't seem to be the case, for example, in the Midwest.

MR. HARVEY: Right. We have tended to look at it on a national level, so we haven't looked at it regionally. It is something we're expanding our capabilities to do, because, you're right, there are differences by region.

COMMISSIONER BROWNELL: So you'll expand your capability by -- are they collecting information, basically?

MR. HARVEY: We've begun to look at different things; we've begun to look at coal levels.

For a long time, it was sort of peripheral, as to what we were doing, but as a key generating component, it's obviously become more and more important, so we're catching up on that one.

COMMISSIONER BROWNELL: Can EIA break it down regionally?

MR. HARVEY: I believe that they can.

COMMISSIONER BROWNELL: So we'll get that and so we'll be able to do this by what date?

MR. HARVEY: We can report to you in a couple of weeks on it. We'll be glad to do that.

COMMISSIONER BROWNELL: That would be good.

You talked tangentially about you reviewed the weather and what impact that has on price. While I know we're not predictors, other people look at weather kind of a little more as an integrated package.

There are a variety of weather services, some of whom actually predicted some of the hurricane conditions. What are we seeing for this summer?

If it's hot, there's a problem; we know that. Is it likely to be hot, and how does that look on a regional basis?

MR. HARVEY: At this point, the forecasts are still moving around a great deal. Sort of the two key issues are how hot it looks like during the summer. It looks like there may be some regional heat again, but it isn't as strong a pattern as it was last year in terms of, at this time, showing a lot of heat in the West, so you haven't seen the reaction to that.

The other issue, of course, is the whole hurricane-related set of concerns, and I think, most recently, some of the indications -- I won't remember whether it's the El Nino or the La Nina kind of direction, off the top of my head, that seem to be indicating sort of danger.

We are in a higher period of hurricanes than we've been sort of in the past. Having said that, some of the ocean conditions don't necessarily seem quite as bad going into the summer, as a whole. Right now, it is apparently quite warm in the Caribbean, so we are watching for early tropical storms coming out of the Caribbean.

It's sort of unnaturally warm in that area.

COMMISSIONER BROWNELL: Maybe you could give us an update on that, particularly since certain places like California, like the Gulf, are more likely to be impacted by weather, and if it happens in the Gulf, it's more likely to impact the rest of the country on a more regular basis.

Understanding that the weather report is the weather report, we fully understand that.

MR. HARVEY: And as I said, it is material from the market perspective. In a sense, the weather report is as important as the actual weather, because traders do use that information very aggressively in order to set themselves up.

So, simply a weather report, whether it plays out, necessarily, or not, is very important in helping determine some of those prices.

COMMISSIONER BROWNELL: Southwest Connecticut, I think the Connecticut PUC has tried to take steps to address what is a serious infrastructure problem, and what are some political forces beyond their control into getting the infrastructure fixed.

I think you said they had 300 megawatts of demand response available to them. How much of that did they use last summer? I was told that, literally, those programs literally kept the lights on.

MR. WRIGHT: We don't have that information.

COMMISSIONER BROWNELL: It would be good to get that and to see how consistent that will be. I will commend the PUC for doing a great job on that. But you talked about operational changes, and I think that's important. I commend the RTOs for trying to respond to conditions.

In the case, specifically, for California and Southwest Connecticut, you really know changes can affect the fact that they have aging infrastructure, and that generators of the age of both of those are, by and large, unpredictable, so there's a big risk factor there.

I just want to emphasize that, because I think we still tend to ignore that ugly little reality.

You said in your California presentation, that there were some differences between your perspectives, NERC's, and the California ISO. Tell me what those are and how important those distinctions are.

MR. HARVEY: One of the difficult things about assessing reserve capabilities, is you're talking about probabilities, basically. You're sort of assessing how much gambling you're doing in any particular case.

So there's a lot of room for interpretation. In the Cal ISO's discussion of very much the same information, I think, as the CC, they tended to focus more concretely, as we did in here, on the possibility of that combination of outages and high demand, because of temperature.

The CC did an analysis of that, a quantitative analysis of that, I understand, and came up with a sort of probabilistic level of savings and 99 percent chance that won't happen. I don't beleive the ISO made such an interpretation, and I'm not sure we would be completely comfortable with that interpretation.

But, again, you're talking about low-probability conditions, and it's sort of how close to gambling on that, do you want to get? So I guess the difference really is, does the 99-percent calculation mean that we're not saying it's nothing to worry about, but something to worry less about, or is it something to worry more about?

And it might really not be 99 percent; there might be a slightly higher likelihood. We would be, I think, more comfortable with the California ISO's interpretation of that, than we were, necessarily, with the CC's.

COMMISSIONER BROWNELL: So the differences in the odds, how you set the odds, as opposed to what the reality is, we don't disagree on the underlying reality.

MR. HARVEY: Not at all.

COMMISSIONER BROWNELL: Thanks.

CHAIRMAN KELLIHER: I had some questions on gas storage. You have indicated that storage is at record high levels, but I'm curious about the economics of storage.

How do you measure when storage is a good investment? Do you do it by looking at the physical cost of storage and comparing it to the difference in pricing between seasons?

MR. HARVEY: Yes.

CHAIRMAN KELLIHER: If so, what's that spread right now? Is that spread currently -- even though you have record high levels of gas in storage? Is it economically still a good thing to build more storage, because of that spread?

MR. HARVEY: There are a couple of things, I think, in there, that are interesting. There are sort of two classes of motivation for why you'd fill storage:

One is the economics. Can I put gas in today and make more by pulling it out later?

CHAIRMAN KELLIHER: It would be a marketer's rationale.

MR. HARVEY: Exactly. Probably not even the predominant strategy used for injections into storage, which would be more the reliability, we must get it in so that we can get it out.

CHAIRMAN KELLIHER: The utility's rationale.
MR. HARVEY: Right.
Now the market it sending, despite the fact that we are well ahead in schedule in terms of filling storage; we came out of last winter quite full. It's hard in some ways to imagine that we won't be quite full by the time we go into the winter just given current conditions, given the injections today. The injection today was also very strong and above expectations. So it seems like the fundamentals would say or the expectations -- because it's about the future, would say that things will be quite strong. Nevertheless, the seasonal spread between now and the winter is quite large.
CHAIRMAN KELLIHER: Larger than the norm?
MR. HARVEY: Much larger than the norm. It's over $4 right now. It's almost $5 at this point.
Typically at this time of year -- I guess last year it was around 80 cents, the year before it was around 30 or 40 cents. This is extraordinarily large. So in that sense, the motivation to fill storage if you're a distribution company remains there because the market's telling you it's really important to do that right now.
Similarly if you're a trader and you're taking a position in storage to arbitrage, basically the difference in values, it's extremely valuable. So storage right now

from a market perspective is sending lots of signals that it's an extremely valuable thing. It's a little hard to completely understand given the current storage levels and given the strength recently in storage injections how long that will sustain that way.

CHAIRMAN KELLIHER: Is it an anomaly because we've had the warmest January in 112 years and the 9th warmest November and we just ended up the winter with so much in storage? But I can understand why current prices would be depressed by that if the assumption is we'll start off next winter with other levels.

MR. HARVEY: This is what is sort of curious about it. We're in conditions in storage we've never really been in before. We're 0.7 Tcf ahead of average at this point. I calculated it a different way: we're about two months ahead of average storage levels. If you think about it going through the summer we're about one month ahead of where we've ever been in terms of records. So we are genuinely in a very different condition starting in the summer with regard to these storage inventories.

Having said that, as I identified in the presentation, there's a lot of anxiety about the future, a lot of it around weather conditions and hurricane conditions. There's also a lot of anxiety around oil and oil prices based on international conditions. That may be at play to some degree in why that spread is still so high, given our current conditions.

But having said that, with the report today in the first five minutes prices dropped below $6 at Henry Hub for futures. This is the first time we've seen below $6 prices for a while. Every week that there is a good strong injection, if those continue at these high levels, that could likely -- I'm getting into projections -- that could continue to erode based on that kind of a signal.

CHAIRMAN KELLIHER: One last question. Do you think the current spread is anomalous, that it might decline? Do you think 80 cents is a natural spread? Is that what we will revert to, or is that anomalous?

MR. HARVEY: One of the things about the storage system is that in the future it in effect resets itself. As we go through the summer, we'll fill storage. There will come a point where you can't put any more in. That may well create a summer condition where there isn't any place to put extra gas and you actually have to start shutting it in. So there are probably price signals associated with that. However, you go through the winter, the winter will be cold, warm, average, or whatever it is. We'll come out of the next winter -- because you can only fill storage to when it was full, and we'll have reset the system. So we'll be -- wherever we are next year at this time we'll be there, but we will not have been able to carry this advantage in inventory forward without really mild weather.

So I don't know what that spread will necessarily look like. We're so out of the norm right now and by next year we may be in the norm or, based on conditions, we may be somewhere else. But it's probably a pretty high spread right now compared to what we'd expect long-term.

CHAIRMAN KELLIHER: Great. Thank you.

Suedeen?

COMMISSIONER KELLY: Steve, southern California utilities and the Cal ISO, as Nora mentioned, have a very active consumer education demand response program that in the past summers in particular have helped significantly in reducing demand at critical times. It is my understanding that utilities and the RTOs in southwest Connecticut and Long Island do not have similar programs, is that correct, or am I in error?

MR. WIGHT: No, there are demand response programs in other areas as well. They're very active in New York. New England has demand response programs. And Ontario has less demand response resources, but they do have some. I believe they have an additional 200 megawatts or so that they can call on this summer.

COMMISSIONER KELLY: Would you anticipate that if supplies get very tight that the demand response, given the history with demand response in those areas, that that would be sufficient to preclude any rolling blackouts?

MR. WIGHT: Certainly they will use all the demand response that they've got before they get to a blackout condition. Really it's just a matter of how high loads get and how tight the system becomes. System operators go through a series of actions, increasingly severe actions, and the demand response comes well before, for instance, voltage reductions and rolling blackouts.

COMMISSIONER KELLY: So we really don't have enough information or I guess we'd have to predict too much to know whether there's a likely risk of blackouts?

MR. WIGHT: I think as Steve said, there's not a large risk of blackouts anyway. We're not predicting blackouts. It's just a matter of how severe the conditions get.

MR. HARVEY: Again the dangerous conditions are combined heat and high load coming from the heat and then failures of equipment. That's where the vulnerability in southwest Connecticut is. Until they beefed up their transmission infrastructure more and improved their import transmission, they're just tight and vulnerable now.

COMMISSIONER KELLY: It seems with the California bid to the cap increase, the data you showed us earlier, now that the cap has increased, we are seeing better price signals showing that there is in fact demand for fast ramping units and that there is a limited supply.

MR. HARVEY: I think that's exactly right. They're making use of that to send the signal when it's really needed to use these relatively expensive units. And yes, they're doing it to handle ramping issues and it's not necessarily affecting the overall price particularly much.

I would agree with you, I think that's a good signal, because it's really using the market to signal what's going on operationally in a clear way.

COMMISSIONER KELLY: Can you tell from the frequency of these bids and prices whether or not there is sufficient fast ramping units available or do these price signals tell you that more are needed?

MR. HARVEY: I would say a couple things. It's early in the process to be able to answer that and the issues are probably different in different parts of California, so I'm not sure you can quite generalize it that far.

COMMISSIONER KELLY: Thanks.

Turning to coal, as Nora mentioned, there are difficulty in getting the information about coal stockpiles on an unaggregated -- disaggregated, unaggregated basis. We've heard complaints and concerns from various utilities east of the Rockies and in the foothills of the Rockies that if you looked at coal stockpiles unit by unit there are some frightening data out there. There are units that have a very low coal stockpile, for whatever reason. Do we have that information?

MR. HARVEY: We've not tried to look at it on a unit by unit basis.

COMMISSIONER KELLY: I understand that that information almost doesn't exist?

MR. HARVEY: That's quite possible, yes.

COMMISSIONER KELLY: And EIA doesn't gather it unit by unit?

MR. HARVEY: EIA tends to gather things unit by unit but then aggregate in order to end up -- that's sort of their operating procedure, to aggregate in order to sort of get a higher level view of things. So my guess is it's not accessible publicly.

COMMISSIONER KELLY: The data that does come out of EIA, is it delayed a bit in real time?

MR. HARVEY: The most current EIA numbers -- it's January or February at this point -- are EIA numbers, which is why we're relying for current estimation on analysts' estimates.

COMMISSIONER KELLY: Is there any way to get that information on a unit by unit basis without getting it ourselves at this point in time?

MR. HARVEY: Not that I know of.

COMMISSIONER KELLY: Steve, when you say that oil may play a smaller direct role in electricity prices this summer than we've seen in the recent past, isn't our experience that oil has been a floor for gas?

MR. HARVEY: We have. We talked about this during the last winter. Depending on the region, we tend to look at New York because you've got a lot of adjacent oil numbers and gas numbers that you can compare head on head without distance problems. But in New York, for example, resid has tended to be a floor. We've been seeing what appears to be breaking down -- because I think of the differences in the fundamentals on the gas side versus the fundamentals on the oil side, we've seen a sustained period now where gas hasn't gone -- diverged too far below resid in New York, but it's tended now to stay below by a little bit, 25 cents, 50 cents an MMBtu for quite a long time now.

So we're constantly watching for that to continue to sort of diverge on the low side. We really are, I think, recently seeing a change, a shift in that relationship a little bit. We'll see whether that remains or not. That's why it was so interesting to see as much of a difference in Florida and as much of a difference in New York that we could then verify that it was really related to fuel choices.

You would assume that once those changes in choices get made that would tend to firm up the gas price and keep that relationship together. But if you can run through all that changing and still continue to add significantly on the storage side of gas -- which would be the way it would tell what the overall balance looks like -- it would tend to keep breaking that. It's very low compared to history and it's been very low compared to history in that relationship now for a little while.

COMMISSIONER KELLY: These entities that are switching fuel, are they able to switch back and forth in a matter of a day, an hour, or is it longer term?

MR. HARVEY: There's sort of two ways they switch. One is by choice of unit, they stop burning oil in the oil units and start burning gas in the gas units. There seems to be a lot of that. There also seems to be some dual fuel units simply switching what their choices are. To the extent that it's a matter of choosing which unit to use, yes, you can do that very, very quickly. To the extent that it's actually changing the fuel being burned in a particular unit, it would take a little bit longer. My guess -- and we don't have great statistics on the nature of these units and how they operate, is that a lot of it is just simply running gas plants, gas-fired plants instead of running oil-fired plants right now, which is very fast.

COMMISSIONER KELLY: So the bottom line there is that although we see switching to gas from oil, that is not going to change the long-term demand for gas unless gas remains -- is priced better than oil in the long term?

MR. HARVEY: I think it will change the demand. The question is can the gas market absorb it at this point from a variety of things, like incremental supplies, like changing demands, that sort of thing. That we don't know yet. That's why watching the storage injections and all is so interesting and watching these flows changing is so interesting, because it seems to suggest gas has been able to absorb a fairly interesting increase in demand in certain places.

COMMISSIONER KELLY: You said there are continuing outages in the Gulf from the hurricanes?

MR. HARVEY: Yes.

COMMISSIONER KELLY: Is that a permanent outage? I understand we will be looking at permanent outages. Are we still repairing facilities or is the outage we have now the outage we're going to live with?

MR. HARVEY: No, I think we're still repairing facilities. The MMS put out it's last report a couple of weeks ago and they said it was their last report. If I remember correctly, total outages in the Gulf were on the 1.6 billion cubic feet a day level.

MR. PETERSON: 1.3.

MR. HARVEY: Except I think we added in Louisiana, too, so I think it was up to 1.6 if we looked at both of them.

Long-term, the expectation has been it would be down to about half a Bcf a day. So from what we hear as well, there continues to be facilities being fixed and we would expect to have more of that supply come over time. But it may take a very long time in certain cases to do that.

COMMISSIONER KELLY: Do we anticipate that there will be appreciable additions before the winter heating season?

MR. HARVEY: I don't know about the timing.

COMMISSIONER KELLY: Thank you.

COMMISSIONER BROWNELL: Suedeen, you brought up a good idea and you've discussed this before, and that is getting even more discrete data than I had talked about on a regional level. I wonder if it's worth talking to perhaps the associations to see if it's desirable, to see if we can get some kind of a survey going. Maybe the associations want to do it. Because if we do it, it triggers all kinds of complications and approvals and it will be next December by the time we get through the process. But it seems to me it is in fact a problem. We need better information. So maybe the associations -- most of whom are in the audience -- would care to discuss that with their members.

COMMISSIONER KELLY: I agree with you, Nora. I think that is a good idea. We have received complaints or expressions of concern on a utility by utility basis, but obviously a decision to require reporting would be a big decision on our part and have to go through OMB and perhaps unnecessarily burden some utilities. But on the other hand, I think our Office of Market Oversight does an excellent job of doing just that. If we could provide a service relative to coal like we do for gas, that would be helpful.

COMMISSIONER BROWNELL: I think we should probably also talk to NERC if that is ultimately the impact we're looking for, because cost is an issue but reliability is the ultimate issue.

COMMISSIONER KELLY: That's particularly true considering the high price of gas and the interest among utilities around the country of looking at coal for future generation. Which raises the question -- and I don't know the answer -- is the infrastructure for delivering coal adequate to meet increasing demand for coal-fired generation?

CHAIRMAN KELLIHER: I just had a question about the NERC summer assessment, reliability assessment. Are there any differences between ours and theirs? Are there additional areas that they covered that we didn't identify? Did they have good news in theirs where there's been improvements?

MR. WIGHT: I don't think there are significant differences. We rely pretty heavily on their expertise, of course, and they review all of the reliability areas, including those in Canada. I believe their view on southwest Connecticut and southern California, in particular, they flagged those as areas of concern. They mentioned concerns about deliveries of Powder River Basin coal; those are three items they put on their watch list, as they call it, items of particular concern.

CHAIRMAN KELLIHER: Great. Any other questions?

(No response.)

CHAIRMAN KELLIHER: Thank you very much.

SECRETARY SALAS: Next on the discussion agenda is E-1, Preventing Undue Discrimination and Preference in Transmission Service and Information Requirements for Available Transfer Capability.

This is a presentation by Kathleen Barron and Dan Hedberg.

MS. BARRONE: Good morning, Mr. Chairman and Commissioners. My name is Kathleen Barrone of the Office of the General Counsel. With me today at the table is Dan Hedberg of the Office of Energy Markets and Reliability.

After I describe the purpose and applicability of the draft proposed rule before you today as Item E-1, along with several of the proposed reforms, Dan will describe the specific proposed revisions to the Commission's pro forma open access transmission tariff and the Commission's regulations.

Ten years ago, the Commission adopted Order Number 888 requiring non-discriminatory open access to transmission facilities owned by public utilities. Last fall, the Commission issued a notice of inquiry expressing its preliminary view that reforms to the pro forma tariff are necessary to avoid undue discrimination or preference in the provision of transmission service. The draft notice of proposed rulemaking before you today as Item E-1 reflects many of the 4000 pages of initial and reply comments received in response to the NOI.

As a general matter, the purpose of the draft proposed rule is to strengthen the pro forma tariff to assure that it achieves its original purpose of remedying undue discrimination. The draft proposed rule seeks to achieve this goal by increasing the clarity and transparency of the rules applicable to the planning and use of the transmission system. It also provides greater specificity in the pro forma tariff to make undue discrimination easier to detect to facilitate the Commission's enforcement of its open access rules.

At the outset, I should note the core elements of Order No. 888, that the draft proposed rule retains:

First, the draft proposed rule, retains the basic nature of the transmission services being offered, network integration, and point-to-point transmission service.

Second, it proposes to maintain the comparability requirement under which each public utility must treat third parties in a manner comparable to its own bundled retail customers.

Third, the draft proposed rule, preserves the Commission's decision to exercise jurisdiction over unbundled transmission service, but not transmission service provided as part of bundled retail service.

Fourth, the draft proposed rule, reaffirms that functional, rather than structural unbundling, can effectively address undue discrimination, and relies on the use of an improved open access transmission tariff to facilitate the development of competitive wholesale markets.

Finally, the draft proposed rule retains the Commission's current policy on reciprocity, which conditions the use of public utility open access services by nonjurisdictional transmission providers, on those nonjurisdictional transmission providers agreeing to offer transmission access in return.

The draft proposed rule is applicable to all public utility transmission providers, including Commission-approved regional transmission organizations and independent system operators.

As the Commission did in Order No. 888, the draft NOPR proposes to allow public utilities to propose terms and conditions of service that are consistent with or superior to the pro forma tariff.

The draft proposed rule notes that its purpose is not to redesign Commission-approved RTO and ISO markets, and that substantial changes to RTO and ISO markets are not expected as a result of the NOPR.

The first major reform included in the proposed rule, is the consistency and transparency of the calculation of available transfer capability, or ATC.

The NOPR proposes to direct public utilities of the North American Electric Reliability Council, or NERC, and the North American Energy Standards Board, NAESB, to provide for greater consistency in ATC calculation, within six months of the final rule on this proceeding.

The draft NOPR requires that standards be developed to ensure consistency in the components, data inputs, and modeling assumptions that go into the ATC calculation, as well as consistency in the exchange of data between transmission providers.

However, the draft NOPR does not propose to require that a single ATC calculation methodology be used by all transmission providers. It also seeks comment on the scope of desired consistency, such as whether consistency in certain areas, is more important than others.

The draft NOPR also proposes to require greater transparency in the ATC calculation, through the inclusion in each transmission provider's tariff, of its specific ATC calculation methodology, as well as through the posting of relevant data and models on OASIS.

Finally, the draft proposed rule would require transmission providers to post metrics relating to transmission requests that are approved and rejected. The draft proposed rule acknowledges that the Commission will be acting on reliability standards relating to ATC in Docket Number RM06-16, and indicates that such action will be coordinated with the Commission's determinations regarding ATC calculation in this proceeding.

The second major area of reform concerns transmission system planning. The current pro forma tariff does not require an open and inclusive planning process.

This omission creates the opportunity for undue discrimination, and otherwise can serve as an impediment to transmission infrastructure development. Therefore, the draft NOPR proposes to require each transmission provider to participate in an open, coordinated, and transparent planning process.

Each transmission provider's planning process must meet the Commission's eight planning principles that are set forth in the NOPR, and include: Coordination; openness; transparency, information exchange, including review of draft plans; comparability; dispute resolution; regional participation; and the preparation of annual congestion studies.

The draft NOPR recognizes that progress has been made in certain regions to create more open and inclusive planning processes, and it seeks to build on, rather than supplant this progress.

Finally, the draft NOPR recognizes that coordinated planning can be achieved in different regions in different ways.a

Dan will now address the specific revisions to the pro forma tariff.

MR. HEDBERG: Good morning. Though the proposed rule does not initiate broad reform of transmission pricing policy, it does include a number of discrete reforms to the pricing of elements of transmission service.

I will first described the proposed reforms related to transmission pricing, and then turn to proposed modifications to the non-price terms and conditions of open access service.

The first significant proposed pricing reform is a change to the pricing of both energy and generator imbalances. The draft NOPR finds that existing imbalance penalties may be unjust, unreasonable, or unduly discriminatory and may pose undue barriers to infrastructure development, such as from intermittent generation.a

The NOPR proposes to remedy the situation by requiring that both energy and generator imbalances be priced the same way, and sets forth three principles for imbalance pricing:

The charges should, one, be related to the cost of correcting the imbalance;

Two, encourage efficient scheduling behavior, and, three, account for the special circumstances presented by intermittent generators.

Second, the draft proposal will also eliminate the requirement that a customer can receive credits for any new facilities it constructs, only if they are jointly planned. The NOPR finds that this requirement may be serving as a deodorant to joint planning, and that new facilities, like existing facilities, should only be required to meet the integration test in order to receive credits.

Third, the NOPR proposes to eliminate the price cap for reassignments of point-to-point transmission capacity by transmission customers, in place of that cap, which is currently the higher of the maximum tariff rate, or the customer's opportunity cost, capped at the cost of expansion.

The draft NOPR would allow negotiated rates between the customer and its assignee, but not for capacity reassigned by the transmission provider or its affiliates.a

The NOPR finds that eliminating the cap on point-to-point service, can facilitate the greater use of the grid in an economical fashion.

The NOPR also proposes a number of modifications to the non-price terms and conditions of the pro forma tariff. Significant among these are clarifications and potential modifications to long-term, firm, point-to-point transmission service.

Specifically, the draft NOPR proposes to clarify that when the transmission provider determines that its system lacks capacity to fulfill a request for point-to-point service, a transmission provider must use all of its available redispatch options to satisfy a request for firm, point-to-point service, and, at the transmission customer's option, these redispatch options must be studied before the customer is obligated to incur the costs and time delays associated with the study of system expansion options.

The draft proposed rule also seeks comment on whether, alternatively, the Commission should modify the nature of point-to-point service to require that transmission providers offer a conditional firm service that would be subject to curtailment prior to firm service, only in a limited number of hours of the year.

The current pro forma tariff allows a transmission customer taking service of at least one year, a right of first refusal to the transmission capacity, upon the expiration of the contract. Such renewals are known as rollovers, and have generated significant controversy and confusion in the past ten years.

The draft proposed rule would revise the pro forma tariff to extend the rollover right only to those customers taking service of five years or longer, and require a customer to give notice of its intent to renew the contract, at least one year prior to expiration, rather than the current 60 days.

The NOPR finds that this change would make rollover rights more consistent with the long-term planning process.

Another area of reform is a proposed change in the minimum term of firm service. Order No. 888 established a one-day minimum term of point-to-point transmission service.

In response to comments and as a result of several transmission providers' voluntary offers, the draft proposed rule adopts one hour as the minimum term of service that must be offered by transmission providers.

The draft NOPR also proposes to change the reservation priority rules to give priority to pre-confirmed transmission service requests submitted in the same time period as non-confirmed requests.

A number of clarifications are also included in the draft NOPR, addressing areas that have caused confusion in the industry, including those related to the Commission's higher-of pricing policy for network upgrades, modification of transmission service, receipt and delivery points, also known as redirects, and certain clarifications related to the network service.a

In addition, the draft NOPR makes a number of clarifications related to the types of agreements that may be designated as network resources. The process for verifying whether agreements meet the requirements in the pro forma tariff, and the requirement for transmission providers to designate and un-designate network resources on OASIS.a

Finally, the draft NOPR includes a number of proposals to increase the transparency of transmission service provided under the pro forma tariff.a

In addition to those described previously, related to the ATC and transmission planing reforms, the draft NOPR proposes to require transmission providers to post on OASIS, all business rules, practices, and standards that relate to transmission services provided under the pro forma tariff, and further requires transmission providers to include credit review procedures in a new attachment to the pro forma tariff.

The draft proposed rule also includes a number of OASIS posting and reporting requirements that will provide the Commission and market participants with information about each transmission provider's performance of pro forma tariff obligations.

For example, the draft NOPR proposes to require transmission providers to post specific performance metrics related to their completion of studies. Those studies are required to evaluate certain transmission requests under the pro forma tariff.

We would like to take this opportunity to recognize the contributions of the members of the OATT Reform Team, whom we'd like to stand at this time, as they are located throughout the room.

(Applause.)

MR. HEDBERG: The team includes representatives of the Office of Energy, Markets, and Reliability; the Office of General Counsel; and the Office of Enforcement.a

This concludes Staff's presentation. We'd be happy to answer any questions.

CHAIRMAN KELLIHER: Thank you. I want to go first, unless, colleagues?

COMMISSIONER BROWNELL: Go right ahead.

CHAIRMAN KELLIHER: I'll start and speak on this one. It's a big one. As Staff indicated, today the Commission is beginning a major rulemaking proceeding, with one primary goal in mind: Preventing undue discrimination and preference in transmission service.

The Commission has come to the conclusion -- as Staff indicated, we have a preliminary view in the Notice of Inquiry, but we have now reached a legal conclusion that the rules established ten years ago, do allow an opportunity for undue discrimination and preference in transmission service that has important implications under the Federal Power Act.

When the Commission determines that undue discrimination and preference is occurring in a jurisdictional service, we have a duty to act. We must act, we cannot just leave undue discrimination and preference undisturbed.

Now, we have discretion in choosing what policy means we elect on, but we have to do something, we have to act.

What's interesting, is that this is actually the third time we have found that Order 888 allows an opportunity for undue discrimination and preference. The first time was in 1999 in Order 2000, the RTO rulemaking.

When the Commission reached that conclusion, the solution, in advance, was restructuring, encouraging utilities to form and join RTOs.

The second time was in 2002 in the SMB proposed rule, where the Commission found that Order 888 allowed an opportunity for undue discrimination and preference. The solution, in advance, at the time, was also restructuring, in this case mandating RTO participation and standard market design.

Here, we're reaching the same conclusion, that Order 888 allows for undue discrimination and preference, but the solution we're choosing, is very different. It's not restructuring; it's regulatory reform, tightening up the tariff itself.

So this is the third time we've reached the same conclusion, but it's only the first time that we're actually proposing a direct solution of reforming the OATT itself.

I just want to clarify also what we're not doing today. That's probably useful and of interest to people.

We are not forcing utilities to divest transmission; we're not forcing utilities to join RTOs and surrender control of their transmission assets. Instead, we're tightening up the open access rules to eliminate undue discrimination and preference.

We've been very deliberate in the way we've approached this, and I think that's worth noting. We began this effort, really, at least informally, in December of 2004, when the Commission held a transmission technical conference.

At that technical conference, the panelists were asked, do they believe that the Commission's current Order 888, the open access transmission tariff, eliminates an opportunity to engage in undue discrimination and preference?

And the view of all panelists but one was in the negative; that Order 888 does allow for undue discrimination and preference in that entity. The unanimity of that view, I think, was pretty striking.

The process formally began last September when we had the Notice of Inquiry and we developed a record that exceeds 4,000 pages. It's a very strong record. It's sufficient for us to act. We're also acting on very strong legal grounds. The rulemaking is based on our authority under Section 206 of the Federal Power Act.

The courts have held that the Commission has broad remedial authority under Section 206 to prevent undue discrimination and preference, so we're on strong legal grounds. We've also worked very closely with stakeholders, state regulators, transmission owners, and transmission customers, including municipals, rural electric cooperatives, and generators.

We've received a lot of good advice and suggestions in the course of recent months. I think those are reflected in the proposed rules we're considering today.

Now, the proposed rule should not come as a surprise to those who participated in our deliberations in recent months. Our proposals are rooted in the record that we've developed.

They are also strongly grounded in our strongest legal authority. The proposed rules do recognize the need for regional differences.

If you look at the planning proposals that we're advancing in the proposed rules, those are modeled in large part on existing planning processes in the West and Southeast.

Those regions have built strong approaches to regional transmission planning, and also joint planning. We're basically taking some of the successes in those regions and proposing to apply those lessons more broadly.

The transmission planning provisions under the proposed rules reflect the view that transmission planning should not reflect the views of only the native load customers of the transmission owner, but also its transmission customers.

The planning provisions also recognize the reality that the wholesale power markets are regional in nature, they are not national in scope, but they are not, in all cases, neatly defined within state boundaries.

If the market is regional, it seems regional that grid planning should also be regional in nature, but we do recognize the significance of sub-regional planning, as well.a

That's what occurs in the West. There's regional planning on almost a footprint of the entire West, but there's also very significant sub-regional planning processes.

I also want to distinguish transmission planning from implementation of those plans from the actual investment in transmission projects identified in the regional planning process.

The proposed rules require a jurisdictional transmission owner to adopt an open and inclusive transmission planning process, one that reflects the needs of not only the transmission owner and its native-load customers, but also the needs of transmission customers.

We do not impose any new obligation to build in this proposed rule, so that's in the NOT Category, what we are not doing today.

The reforms we are proposing are intended to ensure that existing obligations to build, are meaningful and enforceable. I just want to make it very clear that nothing in our proposed planning reforms, is intended to supplant state jurisdiction.a

We've tried to be very careful in that area. I believe the proposed rules will provide greater information on a range of transmission investment needs and options, information upon which state regulators can rely as they exercise their historic role in ensuring resource adequacy, including performing integrated resource planning.

The proposed rules do not represent a change in Commission policy towards RTOs. We continue to support voluntary RTO formation.

Our proposed rules do not push utilities into RTOs, and the reformed open access rules will apply to all jurisdictional utilities, regardless of whether they are members of RTOs or not.

And the rules apply to the RTOs themselves. I think we've taken a balanced approach.

One hallmark of the extensive comments that we've received in response to the Notice of Inquiry, was to keep Order 888, to strengthen Order 888, and to build on Order 888.a

That's exactly what we've proposed to do. Our proposed rules preserve the native load protections that are in Order 888.a

They preserve state jurisdiction over bundled retail sales. We've preserved the comparability requirement; we've preserved reciprocity, and preserved functional unbundling.

And we've strengthened Order 888 by providing for greater consistency in the calculation of ATC, which is integral to defining the amount of transmission capacity that must be made available for third parties.

We also strengthen 888 by providing for open, coordinated, and transparent transmission planning, and we've strengthened 888 by providing for increased transparency and customer access to transmission information.

The ambiguities in our current open access rules, frustrate the Commission, transmission customers, and the utilities themselves.

The rules frustrate the Commission, because it makes it much harder for us to identify violations and to prove undue discrimination and preference.

The rules frustrate transmission customers because when they are denied access and denied transmission service, the cause of that denial is not apparent to them.

They see a black box, and they suspect abuse is occurring.

It also frustrates the utilities, because the utilities, who are seeking to comply, do not believe they can demonstrate compliance. Just to take an anecdote, I think Entergy is probably a good example. We have certainly seen a host of complaints by Entergy's transmission customers.

They believe that there has been undue discrimination and preference in transmission service in the region. We have had numerous proceedings lasting months and years, and we have not been able to prove that violations have occurred, and Entergy may believe that they have complied all along, but are frustrated that they can't demonstrate that compliance.

COMMISSIONER BROWNELL: Now I believe I covered that territory at our last meeting, thank you.

(Laughter.)

CHAIRMAN KELLIHER: The ambiguities in our current rules operate to no one's advantage, certainly not ours, nor I think the broader public interest. The primary goal of our proposed rules is preventing undue discrimination and preference.

We think open access reform will also achieve secondary goals. It will promote wholesale competition. If parties have more reasonable access, more certain access to the transmission grid, that will significantly improve competition in the wholesale power markets.

But it should also strengthen the grid itself through the planning reforms that we're proposing. As I said, we're not imposing new obligation to build transmission. We are imposing an obligation to implement improved transmission planning.

Our hope is that a more open, coordinated transmission planning process will result in increased transmission investments in the future. Our actions today are also fully consistent with the Energy Policy Act of 2005. I think it compliments the reforms Congress enacted last year, which we have spent very significant time in recent months implementing.

If you look at EPACT, one of EPACT's principle goals was strengthening the transmission grid by also providing open access to the grid and encouraging wholesale competition.

I think the proposed rules we have before us today achieve those goals as well. So I think what we're doing is fully consistent with Congress' policy direction.

I just want to be clear that reforming our open access rules is my top personal priority as chairman.

In recent years, we have steadily reformed our generation policies, through changes in the generation market power test. We take another step in that direction in a few minutes.

But I think it's time to also reform our transmission access policies, and I think the time has come for that. In my view, regulators have a duty to reform rules when they reach a conclusion after due deliberation that those rules are inadequate.

That's exactly what we're doing today. I don't normally speak for my colleagues, but I'm going to say some nice things, so I think they'll forgive me.

COMMISSIONER BROWNELL: We hope.

(Laughter.)

CHAIRMAN KELLIHER: I just want to be clear that I think the views I express today really reflect a common vision, a shared vision and a shared sense of responsibility by all the Commission members.

I just want to thank my colleagues for working on this important reform with me in such a collegial spirit, and I think these proposed rules represent the collective best judgment of all three of us, and also the collective best advice of the staff.

I want to admit that I'm somewhat surprised by the speed with which we're acting today. Perhaps some of the audience are surprised too. But I really think that was only possible for two factors.

First was the collegiality and sense of responsibility of my colleagues, and I want to praise them and thank them. But also secondly, the truly outstanding work of the staff that worked on the OATS reform team.

I'm very proud to be the Commission chairman, but largely because of the staff, the quality of the Commission staff, I have to say that when we set May as a target date, I thought there was virtually on chance that we would achieve it.

But you surprised me incredibly. I think the OATT reform team is an example of some of the unique skills that are here at the Commission. It was a combination of veteran staff, some of whom worked on Order 888 last time, ten years ago, as well as a new staff, some new talent we have managed to draw here to the Commission.

So the team really was an interesting blend of talent, and I want to heap my praise on them and offer my sincere thanks. But I also want to thank the commander-in-chief of this effort, Mr. Moot, our general counsel.

I've been trying to think of what good historical analogy I could draw to OATT reform. It doesn't lend itself easily to historical analogy. But I'm going to try nonetheless.

It came to me this morning. I think the right analogy is Stonewall Jackson's Valley Campaign in 1862.

(Laughter.)

CHAIRMAN KELLIHER: In part because of the speed of our effort. What was interesting about that campaign, Stonewall Jackson was outnumbered 3 to 1. He had about 17,000 men. The Union had over 50,000, but Jackson outmaneuvered the Union troops.

He was much faster in maneuvering his troops and he was also successful in having his troops accumulated, concentrated on the appointed day, ready to fight. I think that's what the OATT team has done today.

(Laughter.)

CHAIRMAN KELLIHER: You've covered a lot of ground. You've maneuvered much faster than I would have thought, and you've arrived here on the appointed day, organized and ready for battle. So I think the analogy works to some extent.

(Laughter.)

CHAIRMAN KELLIHER: Stonewall Jackson had some subordinates, one of whom was a General Richard S. Ewell. His nickname was "Baldy Dick Ewell."

(Laughter.)

CHAIRMAN KELLIHER: Seeing Kathleen's full head of hair --

(Laughter.)

CHAIRMAN KELLIHER: Now it's down a bit. But Jackson had excellent subordinates. If Kathleen were wearing red, I would say she'd be A.P. Hill, because A.P. Hill would always wear a red shirt on the day of battle.

But you wore white, so I'm not sure who your analogous Confederate general would be. But Dan is General Ewell, I think.

(Laughter.)

CHAIRMAN KELLIHER: Next, I just want to emphasize that here we're only taking the first step in the process. If this is Jackson's Valley Campaign it's the Battle of Kernstown, I suppose.

But we're asking for public comment on the proposed rules. We will hold a technical conference on them. But a final rule is months down the road, and we have a lot of work ahead of us, and we recognize that.

With that, I'll ask my colleagues if they'd like to comment. Thank you.

COMMISSIONER KELLY: My first comment is that I hope when we have the technical conference, you will not be coming with your musket.

(Laughter.)

COMMISSIONER KELLY: Secondly, Kathleen, thank you for not wearing red. I'm glad that we didn't have to have a fight today, and John, how do you like Stonewall.

MR. MOOT: No comment.

(Laughter.)

COMMISSIONER KELLY: I'd like to thank the many parties who were really active in commenting and working with our staff, in giving us your perspective on what needs to be changed and how.

The involvement by the industry stakeholders was total and pervasive, and you worked almost as hard as our staff did. But no one worked harder than our staff, and I'd like to join the chairman in thanking you very much. You worked hard and you worked long.

As Joe mentioned, the staff group was very impressive. It broadly represented many interests, not only veterans and newcomers but those people who have worked with tariffs at the front end, the Rate staff, as well as the back end, the Audit staff.

There have been on the team economists, policy advisors, lawyers, as you might expect, but also engineers with real industry experience, and I think that that's really made this NOPR something to be proud of, and something that people will talk about perhaps almost as long as the original Order 888.

I believe that when industry gets a chance to look at this in a detailed way, they'll see that staff has worked very hard in sifting and weighing and evaluating competing perspectives, and coming up with an approach that really balances the interests, and I believe will provide better, more open non-discriminatory access.

There are a few items in the NOPR that I think are particularly meaningful. I'd just like to highlight them. First is the proposal to amend the pro forma OATT to require coordinated open-end transparent transmission planning, not only on a regional level but also on a subregional level.

Since Order 888 was issued, transmission infrastructure improvements have not kept up with the changing needs of the industry, nor frankly even with meeting minimum load growth requirements in many areas.

That wasn't the fault of Order 888, of course. But this order goes a long ways toward helping that situation.

To the extent that transmission-building was thought to be something that would be done in response to competitive forces, I think that this NOPR says loudly, clearly and correctly that transmission is different, market forces can and do work well on the generation side of the industry, but transmission is different.

It is still a natural monopoly in its own right but nevertheless a key one. An enabling infrastructure is important for generation and important for competitive generation.

I sincerely believe that the transmissoin network planning requirement we propose today is not only good for the nation, but absolutely necessary to achieving the nation's goals for the electric industry, as well as to meet the legal requirements of the Federal Power Act, to ensure just and reasonable rates for generation.

I do want to note that at the same time, we are proposing a transmission planning requirement here. We do recognize that we are not the only entity with jurisdiction over aspect of transmission planning and expansion.

We have made that very clear in the NOPR. It's my hope that the other entities with jurisdiction, the states, the local governments, public utilities, will view this proposal as a constructive step that can aid them in their work and of course not interfere with their work.

The second area that I wanted to just touch briefly on is the energy imbalance penalty reform. I am very pleased with this proposal. I think that it will enable renewables, particularly intermittent renewables like wind and solar, to have non-discriminatory access to the grid.

It provides for a cost-based approach to energy imbalances rather than a penalty-based approach that was devised before we had intermittent resources. I believe that cost-effective behavior will result from our approach, and I think it's important that cost-effective behavior be encouraged, not penalized.

So we have proposed to remove penalties that have kept cost-effective behavior, that have needlessly kept wind from the grid, which is particularly important since the American public is interested in renewable energy, and we will be stronger with fee diversity of different forms of generation, including renewables.

Then finally I wanted to discuss the proposed increase in the minimum requirements for rollover rights. From today, one year and sixty-day notice to what we propose here, five years with a one-year notice.

Frankly, I was initially reluctant to take this step, although I had sympathy for the argument made in support of this change. I was concerned about the potential anti-competitive impact of a change that essentially makes it more expensive and more long-term, if you will, for unaffiliated entities to secure transmission on a basis similar to that that transmission owners currently enjoy.

In the end, however, I became comfortable with the change, basically because of other proposals we make today. That should increase the value and thus the remarketability of the transmission that would be purchased for this longer-term.

In other words, while customers will now need to enter into longer-term contracts for transmission in order to secure rollover rights, it should be easier for them to redirect or resell any unneeded portion of those rights that will in turn benefit everyone by helping to maximize the use of the grid, and it should allow independent generators to maintain their competitiveness.

That was an excellent approach, from my perspective of the staff, at looking at the competing interests, taking them seriously and crafting a policy that balances those competing interests in a fair way.

I'm very pleased to vote for this NOPR. I believe that it embodies an appropriate set of balanced policies, and that it will improve open, non-discriminatory and full access to the grid. Thank you.

COMMISSIONER BROWNELL: Thank you. You have been eloquent in your summaries and your comments. I do want to say, Mr. Chairman, that apparently you didn't have the conversation with John Moot that I did yesterday, where he told me that I had to be on my best behavior today --

(Laughter.)

COMMISSIONER BROWNELL: Because I respect his leadership, I am not going to say anything at all about the fact that your example included the words "fight battles" and "Baldy Dick."

(Laughter.)

COMMISSIONER BROWNELL: You owe me big time. How will I talk about franchises today? I just want to step back a minute and tell you what I think. This was just such an incredible process, and why I think we've come up with what I think is an all-inclusive order.

Did it go save the world? Probably not. But I think that one of the terrific experiences for me during this is we talked to real people. We talked to people who are operating systems. Together with the staff, I learned more than I ever thought possible.

I'm slightly dangerous now on the issue of ATC. From the people who are on the ground running, I just want to mention a few of them. Then I want to say that I hope those are the people who the intervenors allow to comment, because this isn't about preserving a business strategy. This is about preventing undue discrimination and a number of other things that I'll talk about.

So I want to really thank Trudy Novak from Florida Seminole; Steve Nauman, the world-renowned expert on ATC from Excelon; Clay Norris from Electra Cities; Ed Tatum from HRDEP; Takut Mansur, where we have organized markets but considerable non-organized markets; Paul Hollis, from National Grid, who made his team available; Rick Serbal and the NERC team; Joe Welsh and the ITC term; Ricky Biddle from Arkansas Coops; John Lucas from the Southern Company and his team.

I really appreciate their willingness to independently, I think, give us their view.

While there might not have been consensus on things, there was remarkable similarity in their comments, including that ATC did need work, and while there may be differences, those differences are probably not as great as we think.

The fact I think consistently said we could and should have done ATC work in consistency many years ago, we won't do it until you tell us to do it. I think that was incredibly important. I appreciate their efforts.

In addition to just what is extraordinary staff work, they took massive amounts of very complicated information and turned it to something that I think everyone can understand.

I think this is the kind of process that the industry, who has been remarkably resistant to change in a country where almost every other industry has truly restructured, I think this is a lesson to be learned.

So with all due respect to the lawyers and the regulatory guardians, I think we need to let the people who have ownership of the day-to-day responsibility of the system do their jobs.

I thank them for doing their jobs, and I thank our staff. I think we started clearly and our obligation is to prevent undue discrimination. While we have chosen not to structurally separate, I would argue that functional separation makes that a more difficult challenge.

That's why the continuous improvement to do 888, started by our colleagues ten years ago, needs to be worked on. But I think there is impact, and it shows that in an integrated system, everything we do has an impact on something else.

So this not only, I think, addresses the issue of undue discrimination, but it addresses the issue of efficiency of using the assets. We're at a time when our country is under huge stress. We're going to ask customers to make enormous investments in building transmission infrastructure.

I think we have an obligation to make sure we're getting the best leverage out of the assets that we have.

Going forward, as we do make huge infrastructure investments, I think this transparency will allow us to make better cost allocation decisions, better siting decisions, better decisions about what actually needs to get built.

To me, it is just alarming that we don't actually know what happens on the grid, how certain things are done and what is wasted and what needs to be done.

Finally, I think that has an impact that clearly we ought to recognize as unreliability and security. We neglect the word "security" I think all too often. At a time again, when our country is under siege, I think that becomes increasingly important.

I think there are other aspects to this that are as important. I think planning ATC calculation, the imbalance rules, the rollover. I just want to be sure we don't have any disparate impact on certain segments of the industry. All of those are important.

But there's a lot of minute detail in here that I think has equally large impact. I'm excited that John Moot felt this was the most painful process he's ever been through. This was the easiest one we've done in a long time, John, and I hope it continues to be easy.

To this day, while we have champagne and I think lots of other goodies, and they're smiling. That's what's extraordinary.

I also want to recognize the rest of the FERC staff, who while we were hunkered down having all the rest of these meetings, have the work of the agency go on, and respected the fact that this was a priority of yours, and who managed to do the day-to-day work in a way that I think we can all be proud of.

I think I want to thank everybody, and I look forward to getting the comments and hope that people are responsible in their comments.

As I said, this is about a whole lot of things. But ultimately, it's about what we do for the customers, and not about preserving a business advantage. Thank you.

CHAIRMAN KELLIHER: Again, I just want to thank the OATT team in particular. You did outstanding work, but the individual accomplishments of Kathleen and Dan I think were superb, and I want to express my personal gratitude to you and the entire team. Thank you very much.

COMMISSIONER BROWNELL: We will get you better nicknames, I promise you.

(Laughter.)

CHAIRMAN KELLIHER: Shall we vote?

COMMISSIONER KELLY: Aye.

COMMISSIONER BROWNELL: Aye.

CHAIRMAN KELLIHER: Aye. Thank you.

SECRETARY SALAS: Next for discussion is E-2, Market-Based Rates for Wholesale Sales of Electricity by Public Utilities. It is a presentation by Kelly Perl, Elizabeth Arnold, Jerome Peterson, Debbie Leahy, Melissa Mitchell, Deborah Dalton, Mary Beth Teague and Cliff Franklin.

CHAIRMAN KELLIHER: Before you start, I want to correct an oversight. I think I inadvertently neglected to thank Susan's staff about the NRC meeting. I recognized Susan for setting the meeting up, and I thanked Joe McClelland and his staff for working on the meeting.

I must have left the impression that Joe McClelland and staff did all the work for the meeting. That's not true. I want to thank Deme and the rest of Susan's staff who worked on that meeting. That's been bothering me all morning, so thank you.

MS. ARNOLD: Good morning, Mr. Chairman.

MS. PERL: Good morning, Mr. Chairman and Commissioners. The draft NOPR in E-2 revises Subpart H, Part 35 of the Commission's regulations to codify the standards of obtaining and retaining market-based rate authority for sales of electric energy capacity.

The regulations proposed in the draft NOPR adopt in most respects the Commission's current standards for granting market-based rates to the draft NOPR and proposes to reform the current four-pronged analysis.

The current four-pronged analysis examines generation of market power, transmission of market power, other barriers to entry and affiliate abuse.

Although the draft order in E-2 does not propose significant changes to our current policies on these issues, it does propose that we characterize our consideration of these issues into a more traditional horizontal and vertical market power analysis.

E-2 also proposes to make compliance with the Commission's affiliate abuse regulations and expressed condition of market-based rate authority.

With respect to horizontal market power, which we formally referred to as generation of market power, the draft Order proposes to retain the current indicative screens that were instituted in the Commission's Order on April 14th, 2004, with certain modifications that reflect the Commission's experience in applying these screens and the comments received in this proceeding.

First, the draft NOPR proposes to modify the treatment of newly-constructed generation to avoid a situation in which all generation becomes exempt from the Commission's market power analyses as new generation is constructed, and older, pre-1996 generation is retired.

Second, although the draft NOPR proposes to retain the default relevant geographic market, it proposes to continue to provide flexibility by allowing sellers and intervenors to present evidence that the market is smaller or larger than the default geographic market.

In addition, the draft NOPR provides guidance as to the factors the Commission will consider in evaluating whether, in a particular case, to adopt an expanded geographic market instead of relying on the default geographic market.

Third, the draft NOPR proposes to change the native load proxy for the wholesale market share screen from the minimum peak day in the season to the average peak native load, averaged across all days in the seasons.

Fourth, E-2 proposes to allow applicants the option of using seasonal capacity instead of nameplate capacity, and to retain the snapshot-in-time approach for the screens, but to allow known and measurable changes for the delivered price test.

With regard to vertical market power and in particular transmission market power, the draft NOPR proposes to continue the current policy under which an open access transmission tariff, which I'll refer to as an OATT, is deemed to mitigate a seller's transmission market power.

However, in recognition of the fact that OATT violations may nonetheless occur, E-2 proposes that violations of the OATT may be cause to revoke market-based rate authority in addition to any other applicable remedies.

The draft NOPR also notes that concerns regarding the adequacy of the current OATT are being addressed in E-1, which was just discussed.

With regard to other barriers to entry, th draft NOPR proposes to continue with the current approach, but provides clarification of what types of factors will be examined and the draft NOPR proposes to combine the other barriers to entry analysis with the rest of the vertical market power analysis.

With respect to mitigation, if a definitive finding of market power is made, or if the seller accepted the presumption of market power, the draft NOPR adopts the mitigation as discussed in the April 14th Order, which can be either the default mitigation or mitigation proposed by the seller and tailored to the seller's circumstances.

The draft NOPR states that the existing cost-based rates on file with the Commission may be used for purposes of mitigation, and seeks comment on the rate methodologies that should apply to cost-based mitigation, including (1) the rate methodology for designing cost-based mitigation, (2) discounting, and (3) how best to protect customers in mitigated markets.

Regarding affiliate abuse, the draft NOPR proposes to discontinue referring to affiliate abuse as a separate prong of the analysis, and instead proposes to codify in the Commission's regulations an explicit requirement that any seller with market-based rate authority must comply with affiliate sales restrictions.

The draft NOPR proposes to address affiliate abuse by requiring the conditions set forth in the proposed regulations be satisfied on an ongoing basis, as a condition of market-based rate authority.

The draft NOPR proposes to retain the Commission's policy that sales of power between a franchised public utility with captive customers and any of its non-regulated power sales affiliates must be pre-approved by the Commission.

To demonstrate that an affiliate sale is just, reasonable and not unduly discriminatory, an applicant has several options, including pricing that sale at a market index that meets certain standards, or conducting a competitive solicitation.

A prohibited affiliate sale that has not been pre-approved will constitute a tariff violation. Now my colleague, Elizabeth Arnold, will conclude the presentation.

MS. ARNOLD: Good morning. The draft NOPR proposes certain reforms to streamline the administration of the market-based rate program.

Significant areas of modification involve the three-year updated market power analysis, which has been referred to as a triennial review or updated market power analysis, that all sellers with market-based rate authority are currently required to file, and the development of a market-based rates tariff of general applicability.

The proposed rule proposes to establish two categories of sellers with market-based rate authorization.

Category 1 sellers would consist of power marketers or producers that own or control 500 megawatts or less of generating capacity in aggregate, and that are not affiliated with a public utility with a franchised service territory.

In addition, Category 1 sellers must not own or control transmission facilities other than limited equipment necessary to connect individual facilities to the transmission grid, or must have been granted a waiver of the requirements of Order No. 888.

Because such facilities are limited and discrete, and do not constitute an integrated grid, Category 1 sellers would not be required to file a regularly scheduled triennial review.

The Commission would monitor any market power concerns for these sellers through the change in status reporting requirement.

Category 2 sellers constitute all other sellers. Category 2 sellers, in addition to the Change in Status reports, would be required to file regularly-scheduled triennial reviews, to ensure greater consistency in the data used to evaluate Category 2 sellers.

The draft NOPR proposes each Category 2 seller to file updated market power analyses for its relevant geographic markets on a schedule that will allow examination of the individual sellers at the same time that the Commission examines other sellers in the region.

The Commission would continue to make findings on an individual seller basis, but would have before it a complete picture of the uncommitted capacity and simultaneous import capability into the relevant markets under review.

In addition, the draft NOPR also proposes to adopt a market-based rate tariff of general applicability applicable to all sellers authorized to sell electric energy capacity or ancillary services at wholesale but market-based rates.

Further, the draft NOPR proposes that rather than each entity having its own market-based rate tariff, which can result in dozens of tariffs for each corporate family with potentially conflicting provisions, each corporate family would have only one market-based rate tariff, with all affiliates with market-based rate authority separately identified in the single tariff.

The purpose of the tariff of general applicability that requires the seller to comply with the applicable conditions of the market-based rate regulations is simply to codify, on a consistent basis, the basic requirements of market-based rate authorization and to reduce the administrative burden and confusion that can occur when there are multiple tariffs in a single corporate family.

At this point, I'd like to invite all team members to stand. I want to acknowledge everyone that made a contribution to this effort, including staff from the Office of General Counsel, the Office of Electric Markets and Reliability and the Office of Enforcement.

(Applause.)

MS. ARNOLD: This concludes the staff presentation. We'd be happy to answer any questions

CHAIRMAN KELLIHER: Thank you. First of all, I want to thank you for your work. This is a major undertaking as well. There is something like 18 years of history here. Is it 18, 1988 -- yes, 18.

About 18 years of history here and a universe of

1,200 companies with market-based rate authorization, a host of individual cases, and you've put it together into a coherent and I think more than coherent hole. I want to thank you for your work on this.

Let me just make a few -- you've described what we're doing, and I think I'm just going to make some comments about why we're acting today, at least my reasons why we're acting.

As I said, the Commission's been granting market-based rates for power sales since 1988. The Commission has always issued market-based rates on a case-by-case basis.

We've naturally never reduced our market power test into the Commission regulations. We've been acting on a case-by-case basis and we're dealing with a universe of 1,200 companies with market-based rate authorization.

One thing we know from our experience with the changes of status rulemaking is that when you do everything case-by-case, sometimes your policy varies over time and you end up with inconsistent applications.

So there is an inherent virtue to putting policies into rules. It limits the possibility of inconsistent applications of the test. So to me, that really arguably is the biggest change we're making here.

Putting it into the rules I think provides greater regulatory certainty. It also minimizes the chance of inconsistent applications of our test. I think that's the biggest change that we're doing today.

As staff indicated, in the past we've applied a four-prong analysis to look at market-based rate applications. We have generation of market power, transmission market power, other barriers to entry and affiliate abuse.

We are making some significant changes to the nature of our analysis. We're making some changes to the interim generation market power test and making that test permanent, at least permanent as things are in the Code of Federal Regulations.

We are really changing the way we're looking at the transmission market power prong. One thing that came out in the December 2004 conference, there was an argument that --

Well, there's an argument that the real thing we should be looking for when we look at transmission market power is vertical market power. Not transmission market power per se, but vertical market power.

The use of transmission to leverage wholesale power sales, I thought that was a very good point. To me, that's the reason why we're changing from generation market power, transmission market power, other barriers to entry and affiliate abuse to a two-pronged test looking at horizontal market power and vertical market power.

I think we're basically applying a more traditional antitrust approach to our market power analysis than what we were doing formerly. I like that approach one, because it's more consistent with antitrust law, but also I actually never have really been satisfied with the third and fourth prong of our market power test.

To me, they've always been ill-defined or even frankly undefined. So the other barriers to entry prong becomes incorporated into the vertical market power prong, and the fourth prong, the affiliate abuse prong, has always really acted -- it's always effectively been a condition of market-based rate authorization, not an area of market power analysis.

It really hasn't been an aspect of market power analysis, but a condition of market-based rate authorization. So we're making a de facto condition or a de jure condition. I think that's always nice.

I'm trying to think. I don't think our proposed rules make a dramatic change or mark some kind of a dramatic departure in the Commission's market-based rate policies.

As staff indicated, we made some changes to the interim market power test, but they're not dramatic changes. This is an area where our legal authority is very clear. It's been tested by the courts recently and the courts found that the Commission does have authority to issue market-based rates.

We certainly have the authority to revise our test over time. I just want to emphasize that this is an area where the Commission has been active for some years. Our authority was challenged in the courts. It was affirmed, but we've been steadily increasing our generation market power test for years.

We've been really reforming our policies in the area of generation market power for years. It goes back to Order 2001, where we tightened up the reporting requirements. We later on raised the generation market power threshold on the April 14th and July 2004 Orders.

We issued changes of status rulemaking, to make sure that we monitored changes in market power by an applicant authorized to charge market-based rates in between triennials.

We've also -- in recent years, we've consistently begun a practice of consistently revoking market-based rate authorizations. When an authorized company fails to submit electric quarterly reports or submit triennial analyses. So we're more strictly applying the conditions of market-based rate authorization.

So we've been steadily reforming our generation policies for years, and this is another step that we take today.

Part of reason for issuing the proposed rules is to relieve the staff of the burden of reviewing triennial market analyses from companies that lack market power. So this one's for you.

(Laughter.)

CHAIRMAN KELLIHER: As we indicated, there's something like 500 unaffiliated power marketers and power producers that own or control 500 megawatts or less of generating capacity, and they do not own or control transmission facilities.

So we are relieving them of the requirement to submit triennial analyses, and relieving staff of the burden of actually reviewing the triennial analysis, but we are still regulating those sellers. They still are subject to the change of status reporting requirement.

So if they no longer stay small, if one of these entities acquires very significant generation, they will either have to get our authorization for the acquisition itself, or they'd have to report the change in status. They might well become subject to the triennial analysis.

I think that's an important change, and I think it will help the staff.

To me, the primary rationale of the proposed rule is simply good government. We're proposing to make our market power test more clear and more consistent with traditional antitrust analysis.

We're incorporating the lessons we have -- from nearly 20 years of experience with market-based rates, and we're providing regulatory certainty in an area where the Commission's policies are complicated.

With that, I certainly support the rule. Colleagues?

COMMISSIONER KELLY: Like the draft order 888 reform NOPR, this NOPR also deals with extremely important and extremely difficult issues. That's required a great deal of time and effort from staff.

I want to thank you again for doing a wonderful job. The effort really shows, and I think when industry has a chance to read the NOPR, it will be impressed by the quality of it.

Here again, with this order, I am pleased to be able to vote for an order that embodies an appropriate set of balanced policies.

On the one hand, this NOPR includes proposals that should increase regulatory certainty for sellers in a variety of ways, and streamline and reduce the regulatory burden for many sellers.

For example, as Joe mentioned, while larger sellers will still be subject to the current three-year update requirement, certain smaller sellers will not be required to file that three-year update.

On the other hand, this NOPR includes proposals that will enhance consumer protection over the status quo. For example, we are proposing to rescind the current exemption from market power analysis requirements for generators built after 1996, since frankly this exemption can no longer be justified.

That change was very important to me, and I am pleased that my colleagues and I have agreed on it. The other thing I'd like to highlight also involves the customer protection issue, specifically cost-based mitigation.

We've required that for power sales and markets where a seller is found to have market power. Cost-based mitigation in fact is the cornerstone of our customer protection effort, where a seller is found to have market power.

However, we've heard from some customers that it may not be sufficient protection where the seller is able to shift its sales to neighboring markets, where it retains market-based rate authority.

This draft NOPR seeks comments on that issue, and on appropriate ways to address it. Customer protection from market power is our number one statutory obligation and priority.

I am voting for this NOPR because I believe it's fully consistent with that goal. Thanks again to the team for their hard work. I'll look forward to hearing comments from the industry.

COMMISSIONER BROWNELL: Thank you. I think it's appropriate that we do 888 and the market-based rate NOPRs on the same day. I very much think that they're a part of different ways of making the wholesale competitive market work.

I was reminded when I looked at this, and some of the items that you both mentioned, of your frequent comments, Mr. Chairman, that market-based rates are a privilege, not a right.

I would say a privilege, not an entitlement, because I think there's a fair amount of feeling in that, and I hope that while this consolidates and I think makes more surgical the way that we're looking at it, I also think it does do a number of things that are important to get our arms around in terms of customer protection, and I'm glad you brought that up.

I am very interested in the comments on the cost-based rates, how they're calculated, age, the other kinds of tools we make available, because I have never been comfortable with our grasp of cost-based rates in this world.

So I'm looking forward to those comments. I also hope that the industry, who periodically say they're confused about what it is we want in the triennial review and when we want it.

Although I think we're pretty clear, apparently some people don't get the big thing, that maybe in consolidating this and making it simpler, people can also avail themselves during this comment period of telling us what they don't understand.

When I talk to engineers, once again simultaneous import studies seem to be fairly well understood. That apparently doesn't translate in all aspects in all companies.

If there's anything that's confusing about what we require, now is the time to bring it up, because frankly I'm a little tired of having people missing dates, saying they didn't understand studies and "the dog ate my homework" excuses.

This is important. It is a privilege, and I think we are taking it more seriously, and I hope the industry takes it more seriously as well. But if we have not been clear, now is the time to ask us for clarity.

I also think it's important to put all the affiliates on one tariff. I think it's enormously confusing and burdensome for everyone, to try to sort through these differences, and I think it leads to inequalities and inconsistencies that are not indicative of a healthy marketplace.

I think also the staff has done a terrific job. I think the comments will be interesting, but I think that we pick to keep the right things, but I think we've asked the right questions and I look forward to further clarity for us.

Thank you. I'm delighted to support this.

CHAIRMAN KELLIHER: Shall we vote?

COMMISSIONER KELLY: Aye.

COMMISSIONER BROWNELL: Aye.

CHAIRMAN KELLIHER: Aye. Thank you very much.

SECRETARY SALAS: Next in your discussion agenda is E-19, which is revisions to record retention requirements for unbundled sales and service, persons holding blanket marketing certificates in public utility market-based rateholder authorities.

It's a presentation by Mark Higgins, and we have somebody else at the table, Chris Wilson.

MR. HIGGINS: Good afternoon, Mr. Chairman and Commissioners. I'm Mark Higgins of the Office of Enforcement. To my left is Chris Wilson of the Office of General Counsel.

I would like to recognize the contributions to this draft order by Ted Jordan of the Office of Enforcement, and Tina Ham of the Office of General Counsel.

The draft order before you amends the Commission's Part 35 and Part 284 regulations to extend from three to five years the record retention requirement applicable to transactions, pursuant to market-based rate authorization held by certain sellers of electricity and related products; blanket certificates for unbundled natural gas sales and services held by interstate natural gas pipelines; and blanket marketing certificates held by persons making sales for resale of natural gas at negotiated rates in interstate commerce.

The draft order's two-year extension of the aforementioned record retention requirement enjoys consistency with Order No. 670, which prohibited market manipulation, and the generally applicable five-year statute of limitations, where the Commission seeks civil penalties for violations of the new anti-manipulation rules, or other rules, regulations or orders as to which price data may be relevant.

As the Commission pointed out in the Notice of Proposed Rulemaking issued in this docket on February 16th, 2006, it would be inconsistent to allow complaints or enforcement actions seeking civil penalties for alleged violations of the Commission's anti-manipulation authority to be commenced more than three years after the transactions giving rise to such actions that were carried out, but not also require that the data and information related to such transactions be retained for at least that long.

No party opposed to the proposed extension of the record retention requirement; rather, only two commenters sought minor clarifications, which we provided in the draft order.

Item E-19 completes the process of revamping the electric and natural gas market behavior rules in light of the prohibition of market manipulation in the Energy Policy Act of 2005, and the anti-manipulation rule promulgated by the Commissoin in Order No. 670.

I'll be pleased to respond to any questions.

CHAIRMAN KELLIHER: I don't have any questions. We called this one largely to eliminate any doubt about notice, about the change in this requirement.

So we had it as a presentation item, largely to make sure that there was no question about notice and applicability. Is this an instant final rule?

MS. COURT: No. Actually, we issued a NOPR on this and so it will be 30 days from publication in the Federal Register.

CHAIRMAN KELLIHER: Thank you. Any questions?

COMMISSIONER BROWNELL: Simply a comment, that you want to make clear that everyone understands the notice. Maybe we can give some assignments to call up certain companies for whom record retention is not a well-understood --

CHAIRMAN KELLIHER: We almost made it.

(Laughter.)

COMMISSIONER BROWNELL: I didn't say anything.

CHAIRMAN KELLIHER: That is the best comment I can muster. Thank the staff for your hard work. We will now say that we have officially fully implemented the market manipulation rules, and the transition from the market behavior rules to market manipulation. That's an accomplishment. Thank you very much.

COMMISSIONER KELLY: Aye.

COMMISSIONER BROWNELL: Aye.

CHAIRMAN KELLIHER: Aye. Thanks.

SECRETARY SALAS: The last item for discussion this morning is C-2, Regulations Implementing the Energy Policy Act of 2005, coordinating the processing of federal authorizations for applications under Section 3 and 7 of the Natural Gas Act, and maintaining a complete, consolidated record.

It's a presentation by Gordon Wagner, John Leiss and William Blome.

MR. WAGNER: Good morning, Chairman and

Commissioners. I'm Gordon Wagner from the Office of General Counsel. With me at the table today are John Leiss from the Office of Energy Projects and William Blome from the Office of General Counsel.

C-2 is a draft notice of proposed rulemaking which continues the Commission's efforts to implement the provisions of the Energy Policy Act of 2005. This draft NOPR addresses two areas of expanded Commission authority with respect to applications to construct new natural gas infrastructure.

First, Section 313 of the Energy Policy Act of 2005 directs the Commission to set a schedule for actions by other federal and state agencies on request for federal authorizations that are necessary for a proposed NGA Section 3 or Section 7 gas project.

The draft NOPR explains that the Commission will either issue a specific schedule for processing or rely on a default schedule under which other agencies' authorizations are due 90 days after the Commission issues its final environmental document.

Or if no such document is issued, other agencies' authorizations are due 90 days after the issuance of the Commission's final order. The schedule set by the Commission only applies to agencies that do not already have deadlines established by federal law.

To provide the Commission with the information needed to determine a reasonable schedule, the draft NOPR would require other agencies to notify the Commission when a request for federal authorization is received.

If the request is complete and if not, what further data or study will be needed, and when the agency anticipates ruling on a request.

Second, Section 313 of EPACT directs the Commission to maintain a complete consolidated record of the decisions of the other agencies responsible for issuing federal authorizations necessary for a gas project.

The draft NOPR proposes to compile this record by requiring agencies to electronically file their decisions and a document index with the Commission. The collective decisions and indices will constitute the consolidated record, which will be the record for any review or appeal of an agency or Commission decision. Thank you.

CHAIRMAN KELLIHER: Thank you very much. Let me just make a few comments.

One of the central policy goals of the Energy Policy Act was to strengthen the U.S. energy infrastructure, and one of the provisions of EPACT that did just that were the amendments to the Natural Gas Act, providing for coordination of federal authorizations and mandating a consolidated record.

Our proposed rules would implement those EPACT provisions. The Energy Policy Act authorizes the Commission to establish a schedule to coordinate the processing of authorizations required under federal law for natural gas projects such as pipelines, LNG import facilities and storage facilities.

As staff indicated, the Commission's schedule for other agencies' review will comply with existing deadlines set by federal law for agency actions.

EPACT also authorized the Commission to compile a consolidated record of each agency's decision to serve as a basis for appeal or judicial review. In my view, the legislation is entirely reasonable, and in the event it's the law, so today we faithfully implement the EPACT provisions.

The Energy Policy Act in no way undermines the review by other agencies, including state agencies acting under delegated authority. They would continue to apply to review applications by project developers in the same manner, applying the same standards.

The Commission may, however, set a schedule for their review, consistent with other federal laws. I look forward to any comments we receive on this proposed rule. Colleagues?

COMMISSIONER KELLY: Kelly. Not only is this the law, but this proposed rule recognizes a good and fundamental principle for making timely, thorough decisions involving multiple agency authorizations. That is, everything done in parallel, not in sequence.

In other words, all state and federal agencies responsible for issuing federal authorizations for NGA Section 307 applications must start their processes early on, and reach final decisions by a date certain.

Actually, the project sponsors will have the key role in ensuring that this happens. They will be the ones who will be required to file requests for these authorizations no later than when they file all their NGA applications.

In fact, the proposed rule even encourages them to make their requests of agencies before filing an application with the Commission. In my mind, this type of scheduling process just makes sense, and I believe it will lead to better, more timely decisions.

Equally important in my view is that the proposed rules respects individual state and federal agency needs and requirements, and it does it in two ways.

First, in setting a schedule for agencies to reach final decisions, the Commission will take into account certain information provided by the authorizing agency, including how much time the agency anticipates it needs.

Second, the proposed rule recognizes that Commission deadlines do not apply to agencies with schedules set by federal law.

Then finally, as required by EPACT 2005, the proposed rule sets forth procedures for the Commission to maintain a consolidated record of proceedings.

I believe that the proposed rule sets forth a process that's reasonable and not unduly burdensome. I would like to add that this Commission has long pledged to work cooperatively with other agencies.

I think that we have a good record of showing that we do that, and I believe that doing so in this instance will expedite not only decision-making but also judicial review, and minimize unreasonable delays in agency decisions.

For all of these reasons, I support the proposed rule, and I know it's a bit of a change from what's gone before, but I think it's an improvement, and I do look forward to hearing comments on the rule.

COMMISSIONER BROWNELL: Not only is it the law, but it's actually a good law. I think this kind of discipline will make for a more robust record, if it's respected. I think it will make for more cooperative work with various agencies.

I think it may end with the customers well-served by a process that is both robust but is also efficient. I think one of the challenges we have and should take some initiative is working with governors, to make sure that they understand what this means.

In some cases, we have seen some understaffed state agencies, particularly in the last five or six years as states have been under some economic pressures. I think we ought to work cooperatively to make sure that people understand in leadership positions what this means.

I'm not going to say anything more, because John Moot is back in the room.

(Laughter.)

CHAIRMAN KELLIHER: Shall we vote? Colleagues?

COMMISSIONER KELLY: Aye.

COMMISSIONER BROWNELL: Aye.

CHAIRMAN KELLIHER: Aye. Let me make one announcement. Why don't we start our 1:00 meeting at 1:15? 1:15. Thank you. To the staff, it's been a good day.

(Whereupon, at 12:25 p.m., the meeting was recessed for luncheon, to be reconvened this same day at 1:15 p.m.)